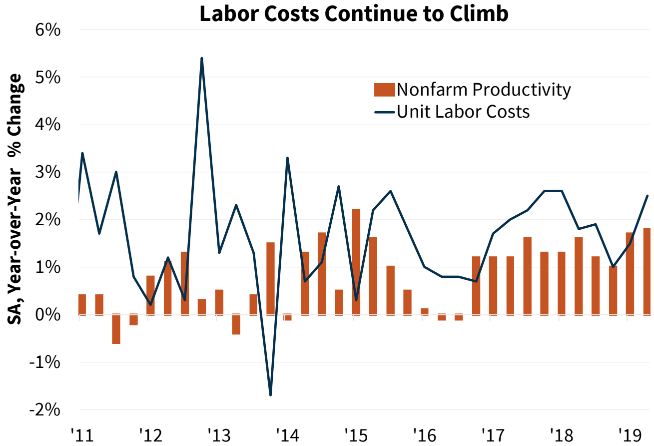
Economics: Retail Sales and Productivity Continue to Rise

This week's economic indicators generally supported our view that continued growth in the U.S. economy will be driven primarily by consumer spending. Equity and bond market volatility, as well as weak business fixed investment, can likely be attributed to a variety of challenges, including threats of escalation in U.S.-China trade tensions, sluggishness in U.S. manufacturing, and weakening growth globally, but U.S. consumers appear to be shrugging off those worries as retail sales rose in July for the fifth straight month. The gain in retail sales was led by sales at non-store retailers, which grew at the fastest pace in six months, but was also healthy at department stores, electronics and appliance stores, and clothing and accessory stores. The week brought mixed news regarding productivity: annualized nonfarm business productivity rose for the fourteenth consecutive quarter in Q2, but the gain was driven mostly by the most significant decline in total hours worked since Q4 2007 and only slightly by an increase in real output. The decline in hours worked is the latest sign that the labor market seems to have started to weaken—and if it continues to do so, we expect that it will eventually cause consumer spending to weaken in turn. On the inflation front, unit labor costs rose in Q2 while Q1 unit labor costs were revised upward significantly, suggesting more inflationary pressure than we previously expected. Increases in headline Consumer Price Index (CPI) inflation and import prices were driven mainly by a rise in energy prices, but the core CPI also rose for the third straight month on a year-over-year basis, sitting comfortably above the Federal Reserve's two-percent target. We expect these signs of inflation to have little bearing on the Fed's near-term policy decisions, given the unsettling status of US-China trade relationships, as well as the slowdowns in global growth and domestic manufacturing. U.S. industrial production fell in July, continuing a downward trend dating from the start of the year and highlighting the continuing weakness in the manufacturing sector; on the other hand, an index of small business optimism rose in July, almost erasing the decline seen in June, with gains in the net share of firms expecting real sales to increase and in the net share of firms expecting the economy to improve.

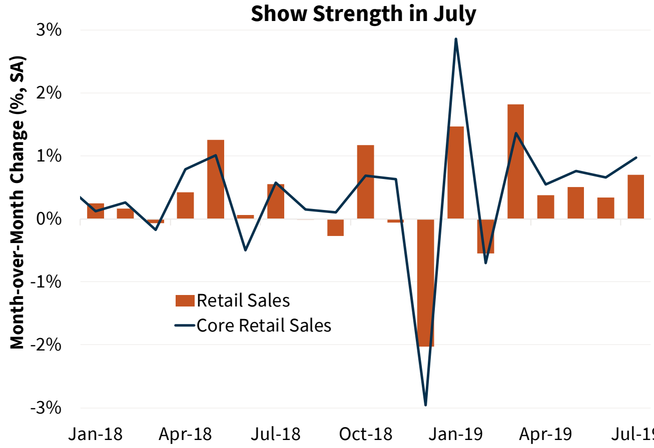
- **Retail sales** rose 0.7 percent in July, according to the Census Bureau. Sales in June were revised down one-tenth to a 0.3 percent increase. Sales at gas stations rose 1.8 percent, while sales at non-store retailers rose 2.8 percent. Core retail sales rose 1.0 percent. From a year ago, headline retail sales rose 3.4 percent and core sales rose 5.1 percent.
- **Nonfarm business productivity** rose 2.3 percent annualized in Q2 2019, according to preliminary estimates by the Bureau of Labor Statistics. Nonfarm real output rose 1.9 percent annualized, while total hours worked fell 0.4 percent annualized. From a year ago, nonfarm business productivity rose 1.8 percent. Unit labor costs rose 2.4 percent annualized and 2.5 percent from a year ago.
- **The Consumer Price Index (CPI)** rose 0.3 percent in July, up 1.8 percent form a year ago. Core CPI (excludes food and energy prices) rose 0.2 percent from a month ago and 2.2 percent from a year ago. **Import prices** were 0.2 percent higher in July, though 1.8 percent lower than a year ago. Excluding fuels, import prices fell 0.1 percent in July and 1.3 percent from a year ago. The Bureau of Labor Statistics produces each of these reports.
- **Industrial production** fell 0.2 percent in July, according to the Federal Reserve Board. Manufacturing output fell 0.4 percent as output of durable and nondurable goods fell 0.2 and 0.6 percent, respectively. Mining output fell 1.8 percent, while utilities output rose 3.1 percent. Capacity utilization fell three-tenths to 77.5 percent.
- **The National Federation of Independent Business (NFIB) Small Business Optimism Index** rose 1.4 points in July to 104.7. The share of firms expecting the economy to improve rose 4 percentage points to 20 percent, and the share expecting higher "real sales" rose 5 percentage points to 22 percent.

Annual Growth in Productivity Rises While Unit Labor Costs Continue to Climb



Source: Bureau of Labor Statistics

Both Core and Headline Retail Sales Continued to Show Strength in July



Source: Census Bureau

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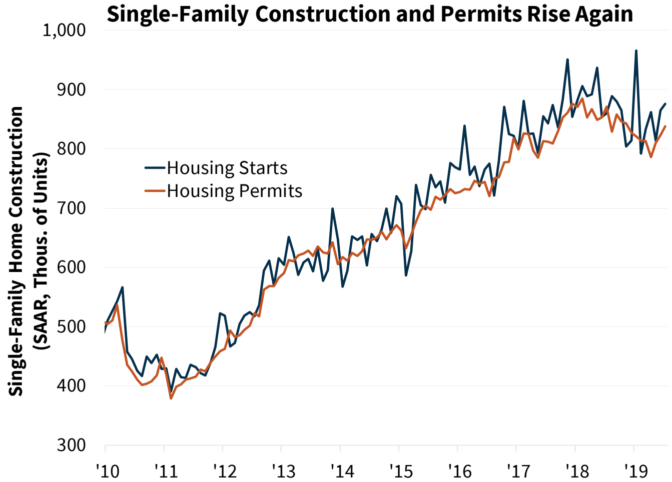
Housing: Housing Starts Fall, Mortgage Delinquencies Rise

Housing news this week supported our expectation of moderate growth in single-family housing construction activity as well as a long-awaited increase in mortgage origination volume in response to the marked recent decline in mortgage interest rates. Total housing starts fell in July for the third consecutive month as a gain in single-family starts—which rose to the highest level since the beginning of the year—was outweighed by a decline in multifamily starts. Multifamily permits, however, jumped by the most since March 2018, making up for the sharp decline seen in June, and single-family permits rose for the third straight month, supporting our expectation of an increase in construction activity in coming months. Our forecast of moderate growth in single-family starts for the remainder of the year is driven by continued demographic demand for additional housing, and bolstered by recent declines in mortgage rates. As homebuilders continue to work down their previously built up inventories of homes for sale, an increase in the pace of starts will likely become necessary. Indeed, mortgage applications jumped last week by the most since the beginning of June, and while the biggest driver was a surge in refinance applications, it was noteworthy that an increase in purchase applications ended four consecutive weeks of decline. Home builder sentiment also improved, with current sales expectations and traffic of prospective buyers rising to the highest level since October 2018, though the index of expected sales over the next six months fell slightly. On a more sobering note, survey evidence showed that the delinquency rate for mortgage loans on one-to-four-unit residential properties increased in Q2 to the highest level since Q1 2018, though the serious delinquency rate ticked down to its lowest level since Q2 2006. We expect to see the delinquency rate continue to increase moderately as part of our expectation that overall economic growth rate will slow and the labor market will weaken. The average rate on 30-year, fixed-rate mortgages was unchanged this week at 3.60 percent, according to Freddie Mac, keeping mortgage rates at the lowest level since November 2016 and down 93 basis points from a year ago.

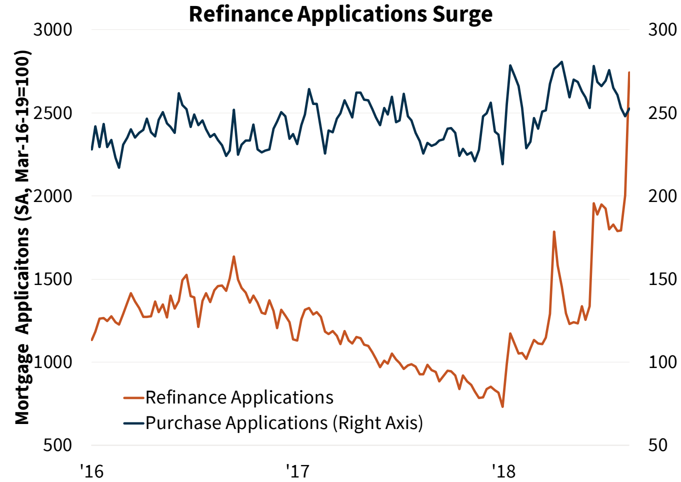
- **Housing starts** fell 4.0 percent in July to 1.19 million annualized units, according to the Census Bureau. Single-family starts rose 1.3 percent to 876,000 units, while multifamily starts plunged 16.2 percent to 315,000. Multifamily permits surged 21.8 percent, while single-family permits rose 1.8 percent.
- **The Mortgage Bankers Association National Delinquency Survey** for Q2 2019 showed that the delinquency rate for mortgage loans on one-to-four-unit residential properties increased 11 basis points to a seasonally adjusted rate of 4.53 percent of all loans outstanding. The percentage of loans on which foreclosure actions were started rose 3 basis points to 0.25 percent. The survey showed that the serious delinquency rate (the percent of loans that are 90 days or more past due in the process of foreclosure, not seasonally adjusted) fell 1 basis point from the prior quarter to 1.95 percent, 35 basis points below the rate a year ago.
- **The National Association of Home Builders/Wells Fargo Housing Market Index** rose 1 point to 66 in August. A reading above 50 indicates that more builders view the single-family market as "good" rather than "poor." The "present sales" component and the "traffic of prospective buyers" component each rose 2 points to 73 and 50, respectively. The "expected sales in the next six months" component fell 1 point to 70.
- **Mortgage applications** surged 21.7 percent in the week ending August 9, according to the Mortgage Bankers Association. Refinance applications jumped 36.9 percent, while purchase applications rose 1.9 percent.

Single-Family Construction and Permits Rise Again



Source: Census Bureau

Refinance Applications Surge



Source: Mortgage Bankers Association

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